Joint Committee on Taxation
February 24, 1981
JCX-5-81

COMPARISON OF PRESENT LAW AND ADMINISTRATION'S CAPITAL COST RECOVERY PROPOSAL

Item	Present law	Administration proposal
1. Underlying concept (Depreciation deduction allowed for decline in value of capital assets (other than land) from wear and tear or obsolescence)	Designed to spread depreciation deductions over period asset used in business so that deductions for cost of asset are matched with the income produced by the use of the asset	Cost of assets recovered over short, predetermined periods unrelated to useful lives (or income produced by use of asset) in order to stimulate investment in productive assets
2. Useful lives (recovery periods) and methods		
A. In general	Taxpayer uses (1) either life based on "facts and circumstances" or guideline life set by the IRS (including ADR variances), and (2) either straight-line or certain accelerated methods.	Mandatory recovery period and accelerated method specified for most tangible property. (Proposed system does not apply to property depreciated in terms other than years (except certain railroad property) or amortized (e.g., leaseholds).)

Item	Present law		Administration proposal	
B. Personal property	Permitted ADR lives[1/]	Methods permitted[2/]	Recovery period	Method
Autos, light-duty trucks	2.5 - 5 years[3/]	New property--straight-line, 200% declining balance, and sum-of-the-years digits ("SYD"). Used property--straight-line only	3 years	Mandatory accelerated rate prescribed--equal to 200% declining balance in early years with a change to SYD in later years to maximize acceleration
R&D equipment	Same as other equipment	Same as above	3 years	Same as above
Long-lived public utility property	14.5 - 60 years[3/]	Same as above	10 years	Same as above
Other equipment (including short-lived public utility property)	2 - 36 years[3/]	Same as above	5 years	Same as above

1/ Under the ADR system, the IRS, on the basis of actual industry experience, specifies a mid-point life for equipment used in most industries; taxpayers may elect lives 20% longer or shorter than the mid-point life.

2/ Straight-line allows a deduction ratably over useful life; accelerated methods such as declining balance and sum-of-the-years digits allow larger deductions in earlier years and smaller in later years.

3/ Permitted lives for specific property depends on type of property and type of industry. The periods shown in the table reflect the 20-percent variances allowed under the ADR system.

Item	Present Law		Administration Proposal	
C. Real property	IRS guideline useful lives	Methods permitted	Recovery period	Methods permitted
Owner-occupied factories, stores, warehouses	45-60 years 4/	Straight-line and, if new, 150% declining balance or SYD	10 years	Statutory rate equal to 200% declining balance in early years, changing to SYD in later years to maximize acceleration
Other nonresidential property	40 - 50 years 4/	Same as above	15 years	Straight-line only
Low-income housing	40 - 45 years 4/	Straight-line or 125% declining balance and, if new, 200% declining balance	15 years	Straight-line only
Other residential property	40 - 45 years 4/	Same as above	18 years	Straight-line only

4/ Taxpayers often use shorter useful lives either based on the facts and circumstances for a specific building or by using component depreciation.

Item	Present law	Administration proposal
3. Beginning of depreciation	Tax year property is placed in service	Tax year property is placed in service, or tax year in which construction of of property begins, if property has normal construction period of at least 2 years
4. Asset accounting	Vintage accounts 5/	Vintage accounts 5/
5. Salvage value	Property cannot be depreciated below estimated salvage value	Entire cost of recovery property is depreciated without regard to possible salvage value
6. Additional first year depreciation	Optional bonus depreciation 20% of property cost up to $10,000 per taxpayer	No bonus depreciation allowed for recovery property

5/ Under vintage accounting, depreciation allowable, gain on disposition, and recapture of depreciation on disposition are determined on an asset-by-asset basis. Assets are accounted for according to the year they were placed in service.

Item	Present law	Administration proposal
7. Disposition of assets	Gain or loss is recognized on sale or other disposition of an asset; allowable depreciation deductions reduce basis of property used in determining gain or loss on disposition	Same as present law
8. Recapture of depreciation		
A. Personal property	Gain is ordinary income rather than capital gain to extent of prior depreciation allowable. (Sec. 1245 "recapture")	Same as present law (Sec. 1245 "recapture")
B. Real property	Gain is ordinary income rather than capital gain only to extent prior allowable depreciation exceeds what would have been allowable if straight-line used. (Sec. 1250 "recapture")	Section 1245 "recapture" for all 10-year property No recapture on other real property.
9. Flexibility		
a.	Option to use useful lives 20% shorter or longer than ADR mid-point lives	Fixed recovery period for recovery property
b.	Option to use straight-line or accelerated, where allowed	Fixed methods for recovery property
c.	Required to deduct all depreciation allowable (i.e., no "banking"); net operating losses can be carried forward 7 years	As under present law, no "banking"; net operating loss carry-forward period extended to 10 years
d.	Investment credit can be carried forward 7 years	Investment credit can be carried forward 10 years
e.	Option to claim depreciation for one half-year on all property placed in service in tax year ("half-year convention") or full depreciation on property placed in service in first half of tax year and no depreciation on property placed in service in second half of tax year ("modified half-year convention")	Half-year convention built into proposed rates.

Item	Present law	Administration proposal
10. Earnings and profits (E&P) (Distributions to shareholders are taxable as dividends only to extent of earnings and profits. Depreciation deductions reduce E&P.)	Based on straight-line depreciation over useful life (including lower limit of permitted ADR lives)	Based on straight-line depreciation over extended recovery period as compared to recovery period used for taxable income If regular recovery period is-- / Extended recovery period is-- 3-year property / 5 years 5-year property / 10 years 10-year personal property / 20 years Real property / 30 years
11. Depreciation of assets held outside U.S.	Accelerated methods generally allowed	Straight-line required
	No variance from ADR mid-point life	Extended recovery period required (same as periods used to compute E&P)
12. Minimum tax and maximum tax		
A. Assets subject to application of minimum tax	Real property and leased personal property	Leased personal property only
B. Amount of tax perference item	Depreciation deductions in excess of amount allowable if straight-line used over actual useful life	Excess of allowable depreciation over amount allowable if straight-line were used over extended recovery period
C. Amount of tax preference offset (reduces amount eligible for 50% maximum tax)	Same as above	Same as above

Item	Present law		Administration Proposal	
13. Investment Tax Credit (ITC)				
A. Amount of credit	Estimated Useful Life	Credit (%)	Recovery Period	Credit (%)
	0 - 3 years	-0-	3-year property	6
	3 - 5 years	3-1/3	5-year and 10-year property	10
	5 - 7 years	6-2/3		
	Over 7 years	10		
B. Recapture of credit	Credit recomputed on early disposition as if actual useful life had been used to determine amount of credit.		Credit recomputed on early disposition by allowing 2% credit for each year held (no recapture if property actually held for at least 5 years)	
14. "At-risk" limitation				
A. Depreciation	Loss generated by depreciation limited if property financed on a nonrecourse basis		Same as present law	
B. Investment credit	None		Credit denied to extent property financed on a nonrecourse basis	

Effective date of Administration proposal

A. In general.--Applies to property placed in service in taxable years beginning after December 31, 1980.

B. Transition rule (phase-in).--Annual election immediately to phase in first $100,000 of 5-year property for each year of transition. As set out in the table below, 5-year and 10-year property have 4-year phase-in; 15-year property has 2-year phase-in. No phase-in for 3-year and 18-year property. Taxpayers may elect to use the 5-year recovery period without phase-in for the first $100,000 of 5-year property for each year of phase-in.

Transition year	If lower limit of permitted ADR life is--	Recovery period is--
1981		
5-year property	5.5 years or less	5 years
	6.0 to 6.5 years	6 years
	7.0 to 7.5 years	7 years
	8.0 to 8.5 years	8 years
	9.0 years or more	9 years
10-year property	All lives	18 years
15-year property	All lives	18 years
1982		
5-year property	6.5 years or less	5 years
	7.0 to 7.5 years	6 years
	8.0 to 8.5 years	7 years
	9.0 or more years	8 years
10-year property	All lives	16 years
15-year property	All lives	16 years
1983		
5-year property	7.5 years or less	5 years
	8.0 to 8.5 years	6 years
	9.0 years or more	7 years
10-year property	All lives	14 years
1984		
5-year property	8.5 years or less	5 years
	9.0 years or more	6 years
10-year property	All lives	12 years